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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

Paul Perpich and Jay Perpich, Appellants

v.

Goodway & Company

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF [illegible]

JURISDICTIONAL STATEMENT

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Loss Securities Regulations - Vol. II 2nd edition, pages 1263 - 1264 - Supp. Vol. II Page 44 (1962)

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

NO. _____

Paul Penjaska and John Penjaska, Appellants

V.

Goodbody & Company

ON APPEAL FROM THE MICHIGAN SUPREME COURT

JURISDICTION STATEMENT

Opinion Below

The opinion of the Circuit Court of Shiawassee County, Michigan is not reported.

The opinion of the Michigan Court of Appeals is reported in 8 Mich. App. 64 (Nov. 67).

The order of the Michigan Supreme Court is not reported.

The opinion of the Circuit Court and Court of Appeals of Michigan and the order of the Supreme Court of Michigan are set forth in the appendix, infra.

JURISDICTION

This action was commenced by appellee in the Circuit Court of Shiawassee County, Michigan to recover a deficit in a joint margin account which was allowed to deteriorate below minimum marginal requirements on a national securities exchange during the period Feb. 3, 1960 to March 29, 1960. Appellants filed defense and counterclaim, claiming deficit and loss of their equity in the account was caused by appellee's violation of certain provisions of the Securities Exchange Act of 1934 and that contract was void as to the rights of Goodbody & Co. under Section 29 of said Act. (U. S. C. Title 15,Section 78).

Appellants attempted to dismiss appellee's action, claiming transactions were subject to regulation and control under the Securities Exchange Act of 1934, that appellee had pleaded a federal claim and, therefore, the Circuit Court was without jurisdiction to hear the case; that Section 27 of the Securities Exchange Act of 1934 granted exclusive jurisdiction to the Federal District Court of all --- " actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. "

Judment in the amount of $5161.79 plus interest was entered in favor of appellee on April 27, 1966. Appellants appealed to the Michigan Court of Appeals on May 12, 1966 and the judgment was affirmed on Nov. 8,1967. Their application for rehearing was denied on Dec. 28,1967 and appellants appealed to the Supreme Court of Michigan which denied their application for leave to appeal on April 9,1968.

A notice of appeal to the U. S. Supreme Court was filed on May 29,1968 in the Mich. Court of Appeals and Michigan Supreme Court. Notice of appeal was also filed in the Circuit Court for Shiawassee County,Michigan on June 10, 1968. The appellants claimed rights under the Securities Exchange Act of 1934, (U. S. C. Title 15, Section 78). a statute of the United States. These rights were referred to by the Supreme Court of Michigan and were an element in its decision,since it upheld the courts below.

A decision of the highest court of a state in which rights under a statute of the United States were claimed by the defendants is reviewable in the U. S. Supreme Court where that statute was referred to by the highest state court and was an element in its decision.

The jurisdiction of this court is conferred by 28 U. S. Code Para. 1257 (1).

That such jurisdiction exists in the circumstances of this case is sustained by the following cases:

Hammond V. Whittredge,204 U. S. 538
Anderson V. Brand,303 U. S. 95
Southwestern Bell Tel. Co. V. Oklahoma -- 303 U. S. 206.

STATUTORY PROVISIONS INVOLVED

The pertinent sections of the following statutes are set forth in appendix, infra pp. 23 ;

Securities Exchange Act of 1934 as amended. (U. S. C., Title 15, Section 78)

General Rules and Regulations Under the Securities Exchange Act of 1934. (17 C F R 240. -)

QUESTIONS PRESENTED

1. Does failure of a stock broker to promptly call for margin or sell securities in his customer's account to bring it within the limits prescribed by the 25% minimum maintenance margin rules of the national exchange of which he is a member, thereby causing a deficit in the account, make the contract void under Section 29 of the Securities Exchange Act of 1934 in regard to the broker's rights ?

   (a) Is the 25% minimum maintenance margin rule of a national securities exchange a " Rule of an Exchange required " within the meaning of Section 29(a) of the Act ?

(b) Is the 25% minimum maintenance margin rule of a stock exchange an integral part of " Rules and Regulations thereunder " promulgated by the Securities Exchange Commission under the Act ?

(c) Is extension of credit in respect to a when-issued security, registered and trading on a national securities exchange, regulated and controlled by the Act ?

2. Does the ruling by the state courts, as applied to the facts in this case, that a brokerage firm's violation of the 25% minimum maintenance margin rule of a national security exchange does not preclude it from recovering losses incurred by it as a result of tardy sale of customer's account, jeopardize the validity of the Securities Exchange Act of 1934 ?

3. Does Section 27 of the Securities Exchange Act of 1934 grant exclusive jurisdiction to the Federal District Court in an action that involves the extension of credit by a broker to his customer beyond the time required by the 25% minimum maintenance margin rules of a National Securities Exchange where the transactions ocurred ?

STATEMENT OF CASE

This case, Paul Penjaska and John Penjaska, appellants V. Goodbody & company arises out of a deficit of $4,050.79 in a joint special cash account, which appellants had with Goodbody & Company, a member of the New York Stock Exchange where the transactions were made, involving 2500 shares of Studebaker-Packard when-issued stock at the price of $40,764.40.

These transactions required margin an initial deposit of 25% of purchase price and 25% maintenance margin or " Mark to Market " under the minimum margin rules of the New York Stock Exchange, a national securities exchange.

Purchases of the Studebaker-Packard when-issued stock were made as follows:

Nov. 24,1959 purchased 500 shares at 17 5/8.
Dec. 3, 1959 purchased 1000 shares at 16.
Jan. 26,1960 purchased 500 Shares at 15 3/4.
Jan. 27,1960 purchased 500 shares at 15.

The appellants credit balance of $10,678.04 covered the initial deposit of 25% purchase price required by the stock exchange margin rules.

During the period from Feb. 3,1960 to March 8,1960 appellee did not make a call for additional maintenance margin, based on the decline in price of Studebaker-Packard when-issued stock.

The following is the status of the account at each full price level on each particular date:

On Feb. 3,1960 at the price of 15 the account needed $1961 and had an equity of $7,413.64.

On Feb. 5,1960 at the price of 14 the account needed $3,836. and had an equity of $4,913.64.

On Feb. 10,1960 at the price of 13 the account needed $5,711. and had an equity of $2,413.64.

On March 1,1960 at the price of 12 the account needed $7,586. and had a deficit of $86.36.

On March 8,1960 the account needed $9,461. and had a deficit of $2,586.36.

On March 8,1960 Goodbody & Company called on appellants for $8500. which they did not provide. On March 15, 1960 appellee sent a sellout notice for March 18,1960, but did not make sale until March 29, 1960.

The sale of the Studebaker-Packard when-issued stock left the appellants' account with a deficit of $4,050.79.

To recover this deficit, appellee commenced suit on June 29, 1961 by Summons and Declaration in the Circuit Court of Shiawassee County, Michigan alleging that Goodbody & Co. is a co-partnership, that appellants are residents of Shiawassee County and are indebted to appellee in the amount of $4,050.79.

The appellants filed an Answer, Petition for Dismissal,with briefs in support thereof, and Counterclaim in the amount of their deposit of $10,678.04 alleging that deficit in appellants account was caused by Goodbody & Co's violation of the 25% minimum margin rules of the New York Stock Exchange and of certain provisions of the Securities Exchange Act of 1934, and that the contract was void under Section 29 of said Act in regard to appellee's rights.

In their petition for Dismissal, appellants sought to dismiss Goodbody & Co.'s suit under the exclusive jurisdiction clause of Section 27 of the Act.

Appellants Petition for Dismissal was denied by Circuit Court for Shiawassee County, Mich.

Trial was held on February 21, 1966.
Trial Court opinion dated March 28, 1966 is attached. (appendix)
Judgment entered in favor of Goodbody & Co. on April 27, 1966. (appendix)

Case was appealed to the Michigan Court of Appeals. Judgment affirmed. Opinion(appendix)

Appellants filed application for rehearing with Mich. Court of Appeals. Application was denied on December 28,1967. Appeals Court statement is found in appendix.

Appellants filed application for leave to appeal to the Michigan Supreme Court. Application was denied on April 9,1968 by the order of the Michigan Supreme Court the highest state court in which a decision could be had in this case.

HOW THE FEDERAL QUESTION WAS RAISED

1. The federal question of exclusive jurisdiction of a Federal District Court in this case was raised at the trial court, the Circuit Court for Shiawassee County,Michigan, by appellants in the following manner;

By pleading: (a) Petition for Dismissal filed July 12, 1961. Vol. I of Record, case No. 9833.

(b) Brief - Supplement to Petition for Dismissal filed Dec. 27, 1961. Vol. I of Record.

(c) Defendants' Brief filed

filed August 29, 1962. Vol. I of Record.

Trial Court ordered pre-trial conference on October 29, 1965 denying appellants motion for dismissal for lack of jurisdiction and ordered case for trial. At the trial on Feb. 21,1966 appellants again raised the question of exclusive federal jurisdiction. (Page 4 - 15 Inc. Transcript).

Page 4 -- The Court: " Just a moment Mr. Penjaska,do you desire to make any statement at this trial ? "
(Appellant) Mr. Penjaska; " Yes, I moveto dismiss this case because this court lacks proper jurisdiction on the subject matter, and if it is all right at this point I would like to proceed with my explanation ".

The Court: " All right ".

Page 6 and 7 of Transcript: Mr. Penjaska:

" The Rule 431 of the New York Stock Exchange requires a minimum deposit of 25% on a when-issued security, and further requires the contract to be " Mark to the Market ". This fulfills the requirments of areas number(7) and (12) of section 19(b) of the Securities Exchange Act of 1934. This rule, therefore is a rule of an exchange required under the Act. It becomes clear,therefore that a debt arising through liquidation of a margin account forced under rules of an exchange, rule 431,required under the Securities Exchange Act of 1934 is a liability created by the Act or rules or regulations thereunder, and is distinguished from a liability which exists at common law. Section 27 of the Securities Exchange Act of 1934 ststes that the District Courts of the United States shall have exclusive jurisdiction of all actions at law brought to enforce any liability created by this title or the rules and regulations there under.

The plaintiff's cause of action for debt is an attempt to evade and circumvent the provisions of the Securities Exchange Act of 1934. Should this court retain jurisdiction of this case, it would be placing it self in the position of upholding an illegal act. We again ask the court to dismiss the plaintiff's case ".

The trial court judge denied the motion. Page 15 of Transcript.

The court; ----- The motion is denied. proceed with the proofs.

The opinion of trial court, appendix - (Circuit Court for Shiawassee County, Mich.) states as follows:

> " The District Court --- shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. "

The trial court ruled in the Opinion, Quote; " The Exchange Act does not deprive this court of jurisdiction in the case at bar. "

In the Michigan Court of Appeals the Federal question of exclusive jurisdiction of the District Courts was raised in appellants Statement of questions involved, question No. 14;

> " Does the Circuit Court for Shiawassee County, Michigan have jurisdiction in this case ?

Trial court answered " Yes ". Appellants contend it should be answered " No ". "

Rule 811 (1) of Mich. General Rules of 1963 states:

(1) " Appeals to the Court of Appeals shall be based on original papers, which shall constitute the record on appeal. "

The question of exclsuive federal jurisdiction raised in the trial court was, therefore properly faised on appeal in the Mich. Court of Appeals.

The question of jurisdiction was properly brought before the Michigan Supreme Court. In appellants' application for leave to appeal to the Michigan Supreme Court the following is found in their - " Statement of Facts and Proceedings " :

> " In their Petition for Dismissal, appellants argued that margin trading in this stock was regulated by the Securities Exchange Act of 1934 and that Section 27 of said Act granted exclusive jurisdiction to the Federal District Court. Appellants filed brief in support of this stand as ordered by the Trail Court, Appellee filed a brief contending that Circuit Court may entertain an action in debt. "

HOW FEDERAL QUESTION WAS RAISED(Continue)

At trial held February 21,1966 Motion for Dismissal was denied.
Trial Court Opinion dated March 28,1966 is attached. (appendix)
Judgment entered in favor of Plaintiff April 27,1966 - appendix.
Case was appealed to the Mich. Court of Appeals. - appendix. Judgment was affirmed in all respects. Appellants filed application for rehearing with Court of Appeals.

This was denied on December 28,1967. Appeals Court statement attached. Appendix

The question of jurisdiction was referred to and was an element in the Michigan Supreme Court order denying application for Leave to Appeal since it affirmed the decision of the Michigan Court of Appeals which took the decision of the trial court as its own. The trial court ruled as hereinfore stated, quote:

> " The Exchange Act does not deprive this Court of jurisdiction of the case at bar ".

Appendix:

Trial Court Opinion.
Mich. Court of Appeals Decision.
Michigan Supreme Court order.

2. The federal questions concerning the validity of the Securities contract between appellants and appellee under the Securities Exchange Act of 1934 and of the application of said Act generally to the transactions were brought up at the trial court by appellants:

(1) By pleadings: (Vol. I of Record)
  (a) By written answer, Affirmative Defenses, and Counterclaim.
  (b) By Petition for Dismissal
  (c) Brief-Supplement to Petition for Dismissal.

The appellants claimed violations by Goodbody & Co. of provisions, rules and regulations of the Securities Exchange Act of 1934, as amended, pretaining to the transactions in the Studebaker-Packard when-issued securities and that the contract was made void therby.

(2) At Trial:

The appellants testified that section 19(b) of the Securities Exchange Act of 1934 requires a national exchange to have rules for the protection of investors, among them being number (7) Time and Method of Making settlements, payments, and closing out of accounts, and number (12) Minimum deposits on margin accounts; (pages 63-64 of Transcript) that rule 431 of the New York Stock Exchange, (Vol. II of Record, item 10), was a rule of an exchange required under the Act, fulfilling the requirements of these areas of section 19(b); (pages 68 of transcript) and that Rule 431 provides for a 25% minimum deposit and 25% minimum maintenance margin on a when-issued security in a special cash account. (Page 67 of Transcript).

Appellants testified that the broker is required to maintain the account within these limits (pages 67-68 Transcript). Appellants claimed Goodbody & Co. violated Rule 431 by taking no action to protect appellants' account from deterioation. (Page 69 of Transcfipt). The contract was, therefore, appellants claimed made void under section 29 of the Securities Exchange Act of 1934 in regard to rights of Goodbody & Co. (Pages 76 - 78 Transcript).

Trial Court ruled (Opinion attached, appendix) that violation by broker of the 25% minimum margin rules of a national exchange does not preclude broker from recovering losses occurred from resulting deficit in his customer's account and that there was a vast difference between rules promulgated by the New York Stock Exchangeand those promulgated by the Securities Exchange Commission. The trial court cited the case of Irving Weiss & Co. V. Offenberger - 220 N. Y. S. 2nd 10001 (Vol. II) as being on all fours with the case at bar.

The federal questions concerning the validity of the contract between the parties under the Securities Exchange Act of 1934 and its general application to the transactions were presented to the Michigan Court of Appeals for review in appellants brief. (Mich. Court of Appeals Record).

The Appeals Court upheld the trial court judge, November 8,1967 commenting;

" We are satisfied that he correctly applied the pertinent law ". (Appendix)

The above federal questions were again presented to the Appeals Court by appellants in their Application for Rehearing (Mich. Appeals Court Record). This rehearing was denied. (appendix). Whereupon,appellants filed application for leave to appeal in the Supreme Court of Michigan again presenting in their brief to the Court the federal questions of validity of securities contract between the parties under the Securities Exchange Act of 1934 and its application generally, to the Studebaker-Packard when-issued securities transactions.

The Michigan Supreme Court denied the application for leave to appeal in its order dated April 9, 1968. (appendix)

These federal questions were,therefore, properly raised by appellants in the trial court and properly raised for review in the Appeals Court and in the Supreme Court of Michigan.

The question of validity of the Securities contract between appellants,Paul Penjaska and John Penjaska and appellee Goodbody & Co. under the Securities Exchange Act of 1934 and its general application to the securities transactions were considered, but rejected

by the trial court, by the Appeals Court, and by the Supreme Court of Michigan.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

This appeal presents substantial federal questions involving the effectivness of the Securities Exchange Act of 1934 to regulate and control the extension and maintenance of credit by a broker to his customer on the national securities exchange and regarding whether the Federal district courts have exclusive jurisdiction in an action at law that involves such extension and maintenance of credit.

The Michigan courts have ruled, in this case, that a broker's violation of the 25% minimum margin rule of a national securities exchange does not give his customer a cause of action against the broker under the Act, nor does it preclude the broker from recovering from the customer losses incurred as a result of carrying an undermargined account.

At issue here in this appeal is whether the violation of the 25% minimum margin rules of the New York Stock Exchange, a national securities exchange, amounts to a violation of a " Rule of an exchange required " by the Act or " of any rule or regulation thereunder ", (Section 29) or whether these 25% minimum margin rules are merely administrative rules made chiefly for the protection of the broker.

The minimum margin rules of the national stock exchange provide the effective means by which credit is regulated and controlled on a national exchange pursuant to the rules and regulations promulgated by the Federal Reserve Board and the Securities Exchange Commission, the two governing agencies of the Federal Goverhment.

The Michigan Courts decided this case under common law holding the Securities Exchange Act of 1934 inapplicable to this case. (See specifically headnotes and references thereto in Mich. Appeals Court decision, 8 Mich. App. 60) (Appenix).

The trail court cited the case of Irving Weiss and Co. V. Offenberger (1961) (220 N. Y. S. 2d 1001) as being on all fours with the case at bar. The Weiss case takes as its substance the ruling in Nichols and Co. V. Columbia Credit Corp. (126 N. Y. S. 2d 715) a case involving a commodity account on a commodity exchange --- a case at opposite poles to the one at bar, since trading in commodities is regulated and controlled by the Commodity Exchange Act, and securities are regulated and controlled by the Securities Exchange Act of 1934.

A case that parallels the Weiss case is Staley V. Salvesen (1963) (35 D. & C. 2d 318), appendix, since defendants in both cases pleaded noncompliance with section 7 of the Act and Regulation T promulgated by the Federal Reserve Board pursuant to the Act.

In Staley V. Salvesen, the court had this to say:

> " Failure strictly to abide by the credit regulations may subject the broker or dealer to many sanctions, administrative, civil or criminal---- in addition to recieving sanctions, the violator of the Act and regulations thereunder may lose rights, for section 29 (b) makes void, as to the violator, every contract either (1) made in violation, (2) preformed in violation, (3) the preformance of which involves the continuance of any relationship or practice in violation: Cohen V. Roth child & Co. USDC N. Y. (1958) '57 - '61.

CCH Fed. Sec. Law Rep., para 90, 849; Klien V. D. R. Comenzo Co. 207 NYS 2d 739 (1960); Accord, Bankers Life and Casualty Co. V. Bellanca Corp. 288F. 2d 784c (7th Cir., 1961) Diligent research has revealed only one case with contrary results. Irving Weis & Co. V. Offenberger, 220 N. Y. S. 2d 1001 (1961), has recieved critical comment by Louis Loss in his 1962 Supplement to Vol. II Securities Regulations, P 44. Moreover, the violating broker may not assert wrongful participation of the customer in the transaction as a defense; Remar V. Clayton Securities Corp., 81 F. Supp. 1014 (D. C. Mass 1949) ".

Louis Loss in his 1962 Supplement to Vol. II Securities Regulations, P. 44 states:

> " ----- Irving Weiss & Co. V. Offenberger, - Misc. 2d ---, 220 NYS 2d 1001, 1003 (N. Y. City Mun. Ct. 1961) in a confused opinion in which court referred to Regulation T as " a rule of an exchange " court gave judgment to broker for customer's debit balance on ground that customer failed to establish any " proximate or causal relationship to the claimed violation". "

The opinion of the trial court in this case is also confused. It states that, " Beginning with Feb. 3, 1960 the account needed margin but the account was not called. Then the Court states: " The defendants did not maintain the margin as agreed, and were sold out after proper demand had been made and the demand ignored.

The testimony of Mr. Russell G. Mann, Jr. (pages 89-93 Transcript) shows that Goodbody & Co. waived compliance with the 25% minimum margin rule of the New York Stock Exchange (Rule 431, Vol. II, item 10 - Record). This can also be extracted from

the appellee's Declaration filed June 29, 1961 (Vol. I of Record) and from the letter of Mr. Harold P. Goodbody to Paul Penjaska dated June 8, 1960 (Defendants exhibit "E" Vol. II, item 9 - Record.)

The enforcing of the contract of Goodbody & Co. against appellants by the Michigan Courts deprives appellants of their rights under the non-waiver provision of Section 29 (a) of the Act.

The Securities Exchange Commission promulgated Rule 12f-1 (17 CFR 240.12f-1) pursuant to section 12(b) of the Act, Rule 12d-1 pursuant to 12d (17 CFR 240.12d-1), and Rule 12a-5 (17 CFR. 12a-5) pursuant to section 12 (a). This was the authority under which Studebaker-Packard when-issued securities were granted trading privleges on the New York Stock Exchange.

Section 12(f) para. (6) states: " Any security for which unlisted trading privleges are continued or extended pursuant to this subsection shall be deemed to be registered on a national securities exchange within the meaning of this title. The powers and duties of the Commission under section 19(b) of this title shall be applicable to the rules of an exchange in respect to any such security. "

There is little doubt that rule 431 of the New York Stock Exchange, the rule that sets the 25% minimum deposit and 25% maintenance on the Studebaker-Packard when-issued securities transactions involved in this litigation, is a rule of an exchange required under section 19(b) of the Act; Colonial Realty Corp. v. Bache & Co. (358 F 2d 178) (1966), Fifth Avenue Coach Lines v. New York Stock Exchange (270 N. Y. S. 2d 852 (1966).

Louis Loss in his Securities Regulations Vol. II, 2nd edition p. 1265 states:

> " The statute gives the SEC not the Board, authority over exchange's margin rules. They are one of twelve specific catagories of exchange rules specified in para. 19 (b) of the Act. "

Section 29(a) makes void any condition, stipulation or provision ,that binds " any person to waive compliance with any provision of this title or of any rule or regulation thereunder,or of any rule of an exchange required thereby. "

The trial court ruled that appellants agreed to maintain the 25% minimum margin requirement of the exchange. The contract therefore, contained either a " condition, stipulation or provision " binding appellants to waive Goodbody's compliance with " any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby. " The contract was, therefore, made void as to the rights of Goodbody & Co. under the non-waiver provision of Section 29(a). Appendix.----- Reader v. Hirsch & Co. 197 F. Supp. (1961).

The trial court erred in enforcing the illegal provisions in the contract. In Klein v. Comenzo Co. (207 N.Y.S. 2d 739) the Court held:

> " It is the public policy of the United States to discourage and prevent the purchase of stock on extended credit. It is not necessary to plead illegality of a contract contrary to public policy, and the court will, of its own motion, deny relief without reference to the state of the pleadings, whenever it becomes apparent that the agreement is antagonistic to to the interests of the public."

In view of the important role the minimum margin rules of an exchange play in the regulation and control of credit on the national securities exchanges and in broker - customer relations involving the extention and maintenance of credit on such exchanges it is in the public interest that the U. S. Supreme Court decide the questions submitted by this appeal.

2. This appeal also presents a substantial federal question regarding whether the Federal District Courts have exclusive jurisdiction in an action at law that involves extension of credit by a broker to his customer on a national exchange.

Appellee in his Declaration (Vol. I of - Record) stated: " This credit balance covered the 25% deposit made under the rules of the New York Stock Exchange for the above purchases. During the period Feb. 3, 1960 to March 8, 1960, plaintiff (appellee) did not make a call for an additional cash deposit based on the decline in price of Studebaker-Packard when-issued stock ----- The plaintiff eventually sold the said 2500 shares of Studebakdr-Packard when-issued stock on March 29, 1960 and ------- there was a deficit in the amount of $4050.79."

These rules which Goodbody & Co. pleaded were the minimum margin rules of the Exchange --- " Rules of an exchange required " under Section 19(b) of the Act and an integral part of " rules and regulations " promulgated thereunder by the SEC. The deficit created by Goodbody & Co's liquidation of the account, therefore, was a " Liability or duty created by the Act or rules and regulations thereunder. "

In Fifth Avenue Coach Lines, Inc. v. New York Stock Exchange (270 N.Y.S. 2d 852) (1966) the Supreme Court, Appellate Division, of New York held in one catagory of the required rules of an exchange under section 19 (b) --(3) the listing or striking from listing of any security that these rules of the exchange formed an " interlocking federal statutory provision constituting an integrated administrative and judicial procedure " and ruled that the state court lacked jurisdiction over subject matter since it fell " within an area pre-empted by the Federal Government ".

The ruling of the Michigan Courts (appendix) that Goodbody & Co. has pleaded a common law claim --- an action in debt --- poses a threat to the exclusive jurisdiction clause of the Act (Section 27) (appendix). Whenever a broker sought to recover a claim he thought was owed, wherein he violated the Act, he could merely plead an action in debt in a state court and thus take the matter out of the exclusive jurisdiction of a Federal District Court.

The decision in the Fifth Avenue Coach Line case shows it is the subject matter --- the nature of the proceedings ---- rather than plaintiff's claims, that determines the jurisdiction of the court.

CONCLUSION

For the reasons stated, the questions presented by this appeal are substantial and are of public importance. It is respectfully submitted that probable jurisdiction should be noted.

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July 1968

Registration Requirements for Securities

SECTION 12.

(6) Any security for which unlisted trading privileges are continued or extended pursuant to this subsection shall be deemed to be registered on a national securities exchange within the meaning of this title. The powers and duties of the Commission under section 19(b) of this title shall be applicable to the rules of an exchange in respect of any such security. The Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions, or for stated periods, exempt such securities from the operation of any provision of section 13, 14, or 16 of this title.[1]

Powers With Respect to Exchanges and Securities

SECTION 19.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

Jurisdiction of Offenses and Suits

SECTION 27. The district courts of the United States, the United States District Court for the District of Columbia,[1] and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Validity of Contracts

SECTION 29. (a) Any condittion, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.[1]

UNLISTED TRADING

Rule 12f–1. Applications for Permission to Extend Unlisted Trading Privileges.

An application may be made to the Commission by any national securities exchange for the extension of unlisted trading privileges to any security, pursuant to section 12 (f). One copy of such application, executed by a duly authorized officer of the exchange, shall be filed and shall set forth—

(1) Name of issuer;

(2) Title of security;

(3) Information as to the public distribution of such security in the vicinity of such exchange, and the geographical area which is deemed to constitute such vicinity, stating the source of such information;

(4) Information as to the volume of public trading in such security in the vicinity of such exchange during the three calendar months immediately preceding the date of such application, stating the source of such information; and

(5) Any other information which is deemed pertinent to the question of whether the continuation or extension of unlisted trading privileges in such security is necessary or appropriate in the public interest or for the protection of investors.

Rule 12a–5. Temporary Exemption of Substituted or Additional Securities.

(*a*) (1) Subject to the conditions of subparagraph (*a*) (2) of this rule, whenever the holders of a security admitted to trading on a national securities exchange (hereinafter called the original security) obtain the right, by operation of law or otherwise, to acquire all or any part of a class of another or substitute security of the same or another issuer, or an additional amount of the original security, then:

(A) all or any part of the class of such other or substituted security shall be temporarily exempted from the operation of section 12 (a) to the extent necessary to render lawful transactions therein on an issued or "when-issued" basis on any national securities exchange on which the original, the other or the substituted security is lawfully admitted to trading; and

(B) the additional amount of the original security shall be temporarily exempted from the operation of section 12 (a) to the extent necessary to render lawful transactions therein on a "when-issued" basis on any national securities exchange on which the original security is lawfully admitted to trading.

(2) The exemptions provided by subparagraph (*a*) (1) shall be available only if the following conditions are met:

(A) a registration statement is in effect under the Securities Act of 1933 to the extent required as to the security which is the subject of such exemption, or the terms of any applicable exemption from registration under such Act have been complied with, if required;

(B) any stockholder approval necessary to the issuance of the security which is the subject of the exemption, has been obtained; and

(C) all other necessary official action, other than the filing or recording of charter amendments or other documents with the appropriate state

authorities, has been taken to authorize and assure the issuance of the security which is the subject of such exemption.

(*b*) The exemption provided by this rule shall terminate on the earliest of the following dates:

(1) When registration of the exempt security on the exchange becomes effective;

(2) When the exempt security is granted unlisted trading privileges on the exchange;

(3) The close of business on the tenth day after (A) withdrawal of an application for registration of the exempt security on the exchange; (B) withdrawal by the exchange of its certification of approval of the exempt security for listing and registration; (C) withdrawal of an application for admission of the exempt security to unlisted trading privileges on the exchange; or (D) the sending to the exchange of notice of the entry of an order by the Commission denying an application for admission of the exempt security to unlisted trading privileges on the exchange;

(4) The close of business on the one hundred and twentieth day after the date on which the exempt security was admitted by action of the exchange to trading thereon as a security exempted from the operation of section 12 (a) by this rule, unless prior thereto an application for registration of the exempt security or for admission of the exempt security to unlisted trading privileges on the exchange has been filed.

(*c*) Notwithstanding paragraph (*b*), the Commission, having due regard for the public interest and the protection of investors, may at any time extend the period of exemption of any security by this rule or may sooner terminate the exemption upon notice to the exchange and to the issuer of the extension or termination thereof.

(*d*) The exchange shall file with the Commission a notification on Form 26 promptly after taking action to admit any security to trading under this rule; *provided, however*, that no notification

need be filed under this rule concerning the admission or proposed admission to trading of additional amounts of a class of security admitted to trading on such exchange.

(*e*) Rules 7c2–1 and 10b–1 shall be applicable to all securities exempted from the operation of section 12 (a) by this rule.

STATE OF MICHIGAN

IN THE CIRCUIT COURT FOR THE
COUNTY OF SHIAWASSEE

Goodbody & Company, a co-partnership,
No. 9833
Judgment

v. PLAINTIFF,

Paul Penjaska, and
John Penjaska,
DEFENDANTS.

At a session of said court held in the Court Rooms thereof in the city of Corunna, State of Michigan, on this 27 day of April , A.D. 1966.

PRESENT: HONORABLE MICHEAL CARLAND,
CIRCUIT JUDGE

This cause came on to be heard by this Court without a jury on the 21st day of February, 1966. The plaintiff was represented by its attorney, Dale E. Andrews, of the firm of Brownell, Gault & Andrews, and the defendants were represented by themselves, and both of said defendants were present in the Court Room during said hearing and conducted their own defense to said cause and presented their counterclaim against plaintiff, and

The Court having heard and fully considered all proofs presented by the parties to this litigation and having entered its written opinion as to its findings on March 24, 1966.

Therefore, it is ORDERED that this Court's findings as set forth in the written opinion of this Courtt entered and dated

March 24, 1966 are confirmed and accordingly,

It IS ORDERED that the counterclaim of the defendants be and it is hereby denied, and

IT IS ORDERED that a judgment in favor of plaintiff and against defendants, jointly and severally, is hereby entered, in the mount of $5,261.79, being judgment for the principal amount of $4050.79 plus interest thereon in the amount of $1,211.00 for the period April 1, 1960 through March 24, 1966 at 5% per annum.

IT IS FURTHER ORDERED that plaintiff shall recover its costs.

MICHAEL CARLAND
CIRCUIT JUDGE

DATED: April 27, 1966

Prepared by:
Brownell, Gault & Andrews
Attorneys at law
1426 Mott Foundation Bldg.
Flint, Michigan

STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF SHIAWASSEE

GOODBODY & COMPANY, a Co-Partnership,

PLAINTIFF,

V.

Paul Penjaska and John Penjaska,

No. 9833

Defendants

OPINION

The plaintiff is a co-partnership, duly authorized to do business on the state of Michigan. The defendants are residents of Shiawassee County.

The plaintiff is a brokerage house, and a member of the New York Stock Exchange, and beginning in 1958 the defendants became customers of Plaintiff. On February 24,1959, Defendants began to purchase through Plaintiff blocks of Studebaker-Packard (when-issued) stock on margin. The last block was purchased January 26,1960. This was described as a highly speculative stock,and Defendants made their own decisions as to the purchases and did notrely upon advice of the Plaintiff. Beginning with February 3,1960,the account needed margin but the account was not called. The stock continued to decline in value and on March 8, 1960, the Plaintiff called upon Defendants for $8500.00, which defendants did not pay, but asked for further time. Plaintiff maintains that it sent a sellout order on March 15, for sale on March 18th, but at

the request of the Defendants deferred sale until March 29th, at which time the stock was sold, with a resulting loss to Plaintiff in the sum of $4,050.79. Defendants deny that the sale was postponed at their request. The Plaintiff seeks to recover the amount of the loss in this action.

Defendants maintain that this Court is without jurisdiction to hear this case, and base such claim upon the provisions of 15 USCA 78aa, which provides in part as follows:

> " The District Court ---- shall have exclusive jurisdiction of violations of this chapter or rules and regulations thereunder,and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. "

Defendants position might be correct if the action was brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. It is not, however, such action, but is brought to recover a debt claimed to be owed. The Defendants did not maintain the margin as agreed, and were sold out after proper demand had been made and the demand ignored. The Plaintiff has pleaded no federal claim under the Exchange Act. This is a common law claim not predicated upon any federal question. See COLONIAL REALTY CORPORATION V. BACHE & COMPANY, United States District Court, Southern District of New York,No. 63 Civil 2240. The Exchange Act does not deprive this Court of jurisdiction in the case at bar.

The Defendants maintain in their counterclaim that they suffered damages because they were not sold out sooner. They claim that because Plaintiff violated certain rules of the

New York Stock Exchange, that it may not recover in this action. In effect, they say because Plaintiff did not adhere strictly to to the rules of the New York Stock Exchange as to margin, that it may not recover. Admittedly, they were in the office of Plaintiff almost every day, and admittedly they were familiar with the market. At no time did they demand that their stock be sold. Certainly they had as great a duty to protect their account as did the Plaintiff. They did not compalin because Palintiff was lenient. They doubt if complaint would have been made had the price of the stock advanced during the period of leniency. Had the stock not been sold on March 29th their loss would have been greater. The Defendants are confused by the rules promulgated by the New York Stock Exchange and those promulgated by the Securitys Exchange Commission. There is a vast defference. IRVING WEIS AND COMPANY V. OFFENBERGER, decided in New York Municipal Court, No. 119, page 13, December 21, 1961, is a case on all fours with the case at bar. In this case we find the following language:

> " It has come to be recognized in recent years that margin and speculative accounts, although chiefy for the broker's protection as security for credit risks involved in acting for his customer, have a relation to public interest because requirements for large margins are at least believed to have some effect in checking speculation of a nature and extent deemed contrary to public interest .....
> A broker who persistently and intentionally is too indulgent with a customer in respect of margins doubless will find himself in trouble with public authorities charged with the duty of enforcing such statute and regulation or with the governing body of his exchange charged with the duty of enforcing the rules os such exchange;

but it seems to me clear that the mere failure of a broker to enforce strictly and instantly, a margin requirement which the rules of his exchange entitle him to enforce against his customer does not give the customer a cause of action against the broker. The customer is the one who is speculating not the broker. The customer has a strong financial incentive to watch market fluctuations, and there is no suggestion that he lacks facilities for keeping himself advised as to them. It also is easy for the customer to protect himself by giving an order to buy or sell when market reaches a stated point; and I hence think that the customer is the last person in the world who should be heard to compalin that his broker has not been sufficiently exacting and stringent in requiring margin. "

For the reasons given, the Defandants' counterclaim is denied, and Plaintiff may have a judgment in the sum of $4,050.79, plus interest, and may recover costs.

Dated: March 24,1966.

Micheal Carland

CIRCUIT JUDGE.

GOODBODY & COMPANY v. PENJASKA.

1. COURTS—JURISDICTION—BROKERS—MARGIN ACCOUNT.

Claim by defendants that Federal statute, granting exclusive jurisdiction in Federal district courts with respect to violations of the securities and exchange act, precluded jurisdiction by the circuit court over action by plaintiff brokerage house, a member of the New York Stock Exchange, to recover plaintiff's loss on stock purchased by it for defendants, on margin, pursuant to defendants' request, *held*, without merit, where plaintiff's action was a common-law claim for a debt owed, and was not based upon any liability or duty created by the statute (15 USCA, § 78aa).

REFERENCES FOR POINTS IN HEADNOTES

[1] 20 Am Jur 2d, Courts §§ 12–15; 54 Am Jur, United States Courts § 43 *et seq.*

[2] 12 Am Jur 2d, Brokers § 124.

Duty of stockbroker in respect of demand for additional margins before selling securities carried on margin. 76 ALR 1517.

Rights and duties of stockbroker and customer respectively where demand for additional margins is not complied with. 76 ALR 1527.

[3] 12 Am Jur 2d, Brokers §§ 114, 119.

[4–6] 12 Am Jur 2d, Brokers §§ 114, 119, 148 *et seq.*

Duty of stockbroker in respect of demand for additional margins before selling securities carried on margin. 76 ALR 1517.

Rights and duties of stockbroker and customer respectively where demand for additional margins is not complied with. 76 ALR 1527.

2. BROKERS—MARGIN ACCOUNT—DAMAGES.

Claim by defendants that the failure of plaintiff brokerage house more promptly to sell stocks which it had purchased for defendants, on margin, at defendants' instructions, resulted in recoverable damages to defendants, because of the subsequent decline in value of such stock, *held*, without merit, where defendants were admittedly familiar with the market, ordered the purchase of such stock on their own without advice from plaintiff, were in the office of plaintiff almost every day, and at no time demanded that their stock be sold, and particularly where the evidence indicated that defendants requested that any sale of said stock be postponed, since defendants clearly had a duty to protect their own account.

3. SAME—MARGIN ACCOUNTS—RULES OF NEW YORK STOCK EXCHANGE.

Margins in speculative accounts, although chiefly for the broker's protection as security for credit risks involved in acting for a customer, have a relation to public interest because requirements for large margins are at least believed to have some effect in checking speculation of a nature and extent being contrary to public interest.

4. SAME—MARGIN ACCOUNTS.

Mere failure of a broker to enforce strictly and instantly a margin requirement which the rules of his exchange entitle him to enforce against his customer does not give the customer a cause of action against the broker, since it is the customer who is speculating, not the broker, the customer has a strong financial incentive to watch market fluctuations, there is no suggestion that he lacks the facilities for keeping himself advised on market fluctuations, and it is easy for him to protect himself by giving an order to buy or sell when the market reaches a stated point.

5. SAME—MARGIN ACCOUNTS—DAMAGES—VIOLATION OF MARGIN REQUIREMENTS.

Claim by defendants that plaintiff brokerage house was precluded from recovering losses incurred by it on stock purchased by it for defendants on margin, at defendants' request, because plaintiff failed to require defendants to maintain that margin required by the New York Stock Exchange, of which plaintiff was a member, *held*, without merit, since it is the customer who is speculating and not the broker, the customer has a strong financial incentive to watch market fluctuations, there is no suggestion that he lacks facilities

for keeping himself advised as to market fluctuations, and it is easy for him to protect himself by giving an order to buy or sell when the market reaches a stated point.

6. SAME—MARGIN ACCOUNTS.

Judgment for plaintiff brokerage house for losses incurred by it upon the sale of stock purchased by it for defendants, on margin, at defendants' request, *held*, proper, where the findings of fact of the trial court are adequately supported by the evidence and the trial court correctly applied the pertinent law.

Appeal from Shiawassee; Carland (Michael), J. Submitted Division 2 March 2, 1967, at Lansing. (Docket No. 2,088.) Decided November 8, 1967.

Complaint by Goodbody & Company, a copartnership, against Paul Penjaska and John Penjaska to recover losses incurred by plaintiff as the result of the purchase of certain stock, on margin, at defendants' request. Judgment for plaintiff. Defendants appeal. Affirmed.

Brownell, Gault & Andrews, for plaintiff.

Paul Penjaska and *John Penjaska,* in propriis personis.

T. G. KAVANAGH, P. J. This is an appeal from a judgment for the plaintiff entered by the Shiawassee county circuit court. The opinion of the trial judge set out the facts and the position of the parties succinctly and lucidly and explains his application of the law with such cogency that we will adopt it as our own, adding only comment on matters peculiar to this appeal:

"The plaintiff is a copartnership, duly authorized to do business in the State of Michigan. The defendants are residents of Shiawassee county.

"The plaintiff is a brokerage house, and a member of the New York Stock Exchange, and beginning in 1958 the defendants became customers of plaintiff. On February 24, 1959, defendants began to purchase through plaintiff blocks of Studebaker-Packard (when-issued) stock on margin. The last block was purchased January 26, 1960. This was described as a highly speculative stock, and defendants made their own decisions as to the purchases and did not rely upon the advice of the plaintiff. Beginning with February 3, 1960, the account needed margin, but the account was not called. The stock continued to decline in value and on March 8, 1960, the plaintiff called on defendants for $8,500, which defendants did not pay, but asked for further time. Plaintiff maintains that it sent a sell-out order on March 15th for sale on March 18th, but at request of the defendants deferred sale until March 29th, at which time the stock was sold, with a resulting loss to plaintiff in the sum of $4,050.79. Defendants deny that the sale was postponed at their request. The plaintiff seeks to recover the amount of the loss in this action.

"Defendants maintain that this court is without jurisdiction to hear this case, and base such claim upon the provisions of 15 USCA, § 78aa, which provides in part as follows:

"'The district courts * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.'

"Defendants' position might be correct if the action was brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. It is not, however, such an action, but is brought to recover a debt claimed to be owed. The defendants did not maintain the margin as agreed, and were sold out after proper demand had been made and the demand ignored. The plaintiff

has pleaded no Federal claim under the exchange act. This is a common-law claim not predicated upon any Federal question. See *Colonial Realty Corporation* v. *Bache & Co.* (CA 2, 1966), 358 F2d 178. The exchange act does not deprive this court of jurisdiction in the case at bar.

"The defendants maintain in their counterclaim that they suffered damages because they were not sold out sooner. They claim that because plaintiff violated certain rules of the New York Stock Exchange, that it may not recover in this action. In effect, they say because plaintiff did not adhere strictly to the rules of the New York Stock Exchange as to margin, that it may not recover. Admittedly, on March 8, 1960, they asked for further time. Admittedly, they were in the office of plaintiff almost every day, and admittedly they were familiar with the market. At no time did they demand that their stock be sold. Certainly they had as great a duty to protect their account as did the plaintiff. They did not complain because the plaintiff was lenient. I doubt if complaint would have been made had the price of the stock advanced during the period of leniency. Had the stock not been sold on March 29th, their loss would have been greater. The defendants are confused by the rules promulgated by the securities and exchange commission and those promulgated by the New York Stock Exchange. There is a vast difference. *Irving Weis & Company* v. *Offenberger* (1961), 220 NYS 2d 1001, is a case exactly on all fours with the case at bar. In this case we find the following language:

"'It has come to be recognized in recent years that margins in speculative accounts, although chiefly for the broker's protection as security for credit risks involved in acting for his customer, have a relation to public interest because requirements for large margins are at least believed to have some effect in checking speculation of a nature and extent deemed contrary to public interest. • • • A broker who persistently and intentionally

is too indulgent with a customer in respect of margins doubtless will find himself in trouble with public authorities charged with the duty of enforcing such statute and regulation or with the governing body of his exchange charged with the duty of enforcing the rules of such exchange; but it seems to me clear that the mere failure of a broker to enforce strictly and instantly, a margin requirement which the rules of his exchange entitle him to enforce against his customer does not give the customer a cause of action against the broker. The customer is the one who is speculating, not the broker. The customer has a strong financial incentive to watch market fluctuations, and there is no suggestion that he lacks the facilities for keeping himself advised as to them. It also is easy for the customer to protect himself by giving an order to buy or sell when the market reaches a stated point; and I hence think that the customer is the last person in the world who should be heard to complain that his broker has not been sufficiently exacting and stringent in requiring margin.'

"For the reasons given, the defendants' counterclaim is denied, and plaintiff may have a judgment in the sum of $4,050.79, plus interest, and may recover costs."

We have carefully examined the record. We find the court's findings of fact to be adequately supported by the evidence. We are satisfied that he correctly applied the pertinent law. We find no error.

Affirmed, with costs to appellee.

McGREGOR and QUINN, JJ., concurred.

AT THE SESSION OF THE SUPREME COURT OF THE STATE OF MICHIGAN, Held at the Supreme Court Room, in the Capitol, in the city of Lansing, on the 9th day of April in the year of our Lord one thousand nine hundred and sixty eight.

Present the Honorable

John R. Dethmers,
Chief Justice
Harry F. Kelly
Eugene F. Black
Thomas M. Kavanagh,
Theodore Souris
Michael D. O'Hara,
Paul L. Adams
Thomas E. Brennan,
Associated Justices

Goodbody & Company,
Plaintiff

vs 51937

Paul Penjaska, et al
Defendants and Appellants

On order of the court, the application in pro per for leave to appeal is considered, and the same is hereby DENIED, as defendants and appellants have failed to persuade the court that they have a meritorious basis for appeal or that the decision of the Court of Appeals was clearly erroneous.

STATE OF MICHIGAN-ss.

I, Donald F. Winters, clerk of the Supreme Court of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared

the same with the original, a that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Supreme Court at Lansing,

this 9th day of April in the year of our Lord one thousand nine hundred and sixty eight.

Donald F. Winters, Clerk.

Office-Supreme Court, U.S.
FILED
AUG 8 1968
JOHN F. DAVIS, CLERK

No. 270

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

Paul Penjaska and John Penjaska,

Appellants,

v.

Goodbody and Company,

Appellee,

APPELLEE'S MOTION TO DISMISS APPELLANTS' APPEAL

ON APPEAL FROM THE SUPREME COURT OF THE
STATE OF MICHIGAN

BROWNELL, GAULT & ANDREWS
By: Dale E. Andrews
Attorneys for Appellee
1426 Mott Foundation Bldg.
Flint, Michigan 48502
Telephone No. 23 5-2558

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1968

No. ____

Paul Penjaska and John Penjaska,

Appellants,

against

Goodbody and Company,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MICHIGAN

APPELLEE'S MOTION TO DISMISS APPELLANTS' APPEAL

Appellee motions the court to dismiss appellants' appeal from the Supreme Court of the State of Michigan on the following grounds:

1. The appeal does not present a substantial Federal question.

2. The judgment of the courts of the State of Michigan rests on an adequate non-Federal basis.

APPELLEE'S JURISDICTIONAL STATEMENT

Appellee, Goodbody & Company, accepts the findings of fact as set forth in the Opinion of the Circuit Court for the County of Shiawassee, State of Michigan, and which findings of fact were affirmed by the Opinion of the Michigan Court of Appeals. The Opinion of the Trial Court and the Opinion of the Michigan Court of Appeals appear at pages 31 through 42 of the Brief filed in the United States Supreme Court by appellants Penjaska. Those facts clearly indicate that the State Courts had jurisdiction of the matter litigated.

Appellee is a copartnership authorized to do business in the State of Michigan. Between dates November 24, 1959--January 27, 1960, appellants purchased through appellee, 2500 shares of Studebaker-Packard when issued stock using a joint cash account for that purpose. Purchases were made by appellee at appellants' request. These purchases were made as follows:

November 24, 1959 purchased 500 shares at a market price of 17 5/8

December 3, 1959 purchased 1000 shares at a market price of 16

January 26, 1960 purchased 500 shares at a market price of 15 3/4

January 27, 1960 purchased 500 shares at a market price of 15

The account required margin of 25% in accordance with New York Stock Exchange Rules. Securities then held by appellee in appellants' account were pledged as collateral against the foregoing described transactions in compliance with Exchange requirements. This stock was purchased at appellants' request, on a declining market for such stock. Thus, at the date of the last purchase of such stock, January 27, 1960, appellants' account possessed sufficient margin. Thereafter, the market for the stock declined such that on March 8, 1960, appellee called for margin, requesting appellants to bring the account to margin. At that time appellants requested more time. On or about March 27 or March 28, 1960, appellants informed appellee that appellants did not think they would "come up with the money". Appellants were again informed that the account would have to be sold out on March 29, 1960 unless appellants met margin requirements. On March 29 appellants' account was sold out, resulting in a debt due and owing from appellants to appellee in the sum of $4,050.79. Appellants failed to pay that amount to appellee. An action was commenced in the Circuit Court for Shiawassee County, Michigan, that being the place of residence of appellants, by Summons and Declaration in that Court. The

Declaration alleged generally that appellants were indebted to appellee in the amount stated rising out of stock market transactions herein described, and declaring upon common counts for the indebtedness.

The margin on said account remained sufficient until on or about February 3, 1960 when the margin account call was made as before stated; appellants asked for more time and then finally advised appellee that their margin deposit would not be forthcoming.

Although the account sufficiently met margin requirements at the onset, the decline in the stock market price of said stock caused the account to fall below margin, necessitating a call for margin.

It apparently is the position of appellants Penjaska that the failure of appellee to make more timely call for margin violated the rules of the New York Stock Exchange and the Federal Securities Exchange Act of 1934, as amended. It is apparently the position of the appellants that by refusal to pay the margin call, they thereby can force a violation of the Securities Exchange Rules and the Federal Exchange Act of 1934, as amended, thereby rendering their agreements, contracts and the transactions herein described, all void by reason of the provisions of

Section 27, Chapter 2B of the Securities Exchange Act of 1934 (being also 15 United States Code Annotated, Page 410, §78aa).

QUESTIONS PRESENTED

Do the United States Courts have exclusive jurisdiction of the subject matter raised and presented by appellants?

(A) Where margin on an account is sufficient at onset but due to stock market decline the account goes below margin, and the broker calls for margin which the customer declines to pay, has a violation of the Stock Exchange Rules and Federal Securities Act occurred which in and of itself grants exclusive jurisdiction to the Federal Court?

(B) If it be assumed that the broker failed to make a timely call for margin, as described by appellants, does such failure to make timely call for margin thereby grant exclusive jurisdiction to the Federal Courts because of any violation of Stock Exchange Rules or of the Securities Exchange Act of 1934?

ARGUMENT

The Federal Securities Exchange Commission is authorized under the Securities Exchange Act of 1934 to adopt rules and regulations which among other things, may be adopted with respect to setting

requirements for minimum deposits on margin accounts (Section 19 (b) (12) - U.S. Code Annotated, pages 361-363). Likewise, stock exchanges may adopt such rules governing its members as may seem advisable. Rule 431 of the New York Stock Exchange requires minimum deposit of 25% of a when issued security. Appellants reason from the foregoing that since Section 19 (b) of the Securities Exchange Act of 1934 generally requires a minimum deposit on margin accounts, and since said rule of the Stock Exchange was allegedly adopted in conformity with Section 19 (b) of the Securities Exchange Act of 1934, a violation of 431 of the New York Stock Exchange would necessarily be a violation of the Securities Exchange Act of 1934, Section 19 (b). Therefore, appellants have reasoned that the State Courts have no jurisdiction.

Chapter 2B of the Securities Exchange Act of 1934 was designed to cut out sharp practices and fraudulent schemes involving securities (Errion v. Connell, C. A., Washington, 1956, 236 F 2d 447). The test generally used in determining whether or not the Federal Courts do have exclusive jurisdiction over a particular action under the provisions of the Federal Securities Exchange Act of 1934 is cogently stated in Howard v. Furst, 238 F 2d 790 (1956). In that case, Judge Medina quotes with approval the opinion of Justice Cardozo in Gully v. First National Bank in Meridian, 299

U. S. 109 as follows:

> "As in problems of causation, so here in the search for the underlying law. If we follow the ascent far enough, countless claims of right can be discovered to have their source or their operative limits in the provisions of a federal statute or in the Constitution itself with its circumambient restrictions upon legislative power. To set bounds to the pursuit, the courts have formulated the distinction between controversies that are basic and those that are collateral, between disputes that are necessary and those that are merely possible. We shall be lost in a maze if we put that compass by."

Judge Medina, in applying the foregoing rule or test stated:

> "Applying this test, it is clear to us that every essential element of Appellants' case depends upon the common law and the Statutes of the State of New York."

These holdings point out that the Federal Court did not have jurisdiction since the appellants claims were mere excrescence or superfluity, tacked onto what otherwise was sufficient allegations of a claim for relief under the Act. The

rule otherwise stated means that the Federal statutes relied upon by appellants Penjaska must be an essential element of appellants' case, and appellants' reliance thereon must be of such a connection that it will be supported if the Federal law is given one construction and defeated if it receives another. (Gully v. First National Bank in Meridian, 299 U. S. 109).

Appellee's pleadings and Complaint in the State Courts constituted an action in debt and was upon the common counts for debt. These were counts over which the Trial Court of the State of Michigan had jurisdiction. The Answer and Counter Claim of appellants Penjaska in effect charged appellee with breach of contract and carelessness and negligence. There the issue was joined. Up to that point it was clear that the State Court had jurisdiction to determine a contract relationship between the parties and to determine whether or not the contract had been breached by either of the parties. Such matters are basically within the jurisdiction of the State Court. However, appellants Penjaska sought, and now seek, to extend the theory of their case so that it includes reference to the Securities Exchange Act of 1934, thereby attempting to give the Federal Courts exclusive jurisdiction of this matter. Appellants have tacked the provisions of the Securities Exchange Act

of 1934 on to their case through mere excresence and superfluity, in hopes that the United States Supreme Court will see fit to review the matter. Essentially, the basic claim of appellants Penjaska is that the broker was not astute enough to call for margin within the time during which appellants felt it should have been called for. Such a claim constitutes either a charge of ordinary negligence or a charge of breach of contract, which charges and allegations can be resolved in a State Court exercising its jurisdiction. The fact that appellants Penjaska are able, through an elongated reasoning process to collaterally connect their claim and defense to the Federal Securities Act of 1934, does not give exclusive jurisdiction of the matters involved to the Federal Court (Howard v. Furst, 238 F 2d 790 (1956) (Beury v. Beury, 127 Fed. Supp. 786).

In the case of Rospigliosi v. Clougher (1950) (46 South. 2d 170) (certiorai denied, 71 Supreme Court 81), the Supreme Court of the State of Florida held that provisions of the Securities Exchange Act insofar as it refers to contracts in violation thereof being void, means that such contracts may be void only if they violate the rules under the Federal statute; a violation of the New York Stock Exchange Rules does not render a contract void. An alleged

violation of the New York Stock Exchange rule does not thereby give exclusive jurisdiction to the Federal Courts. Remedies provided by State statute and State common law are sufficient.

The case of Colonial Realty Corporation v. Bache & Co. (United States District Court, Southern District of New York, no. 63, Civil 2240 - March 20, 1964--358 F 2d 178) involved facts where a customer brought suit against a broker for conduct allegedly not consistent with provisions of the Securities Exchange Act. The customer alleged that selling securities in a margin account was a violation of a written agreement not to do so unless the equity fell below margin requirements. The customer contended that violation of the Securities Exchange Rule also was a violation of Section 27 of the Federal Securities Exchange Act. The Court held that no Federal claim had been pleaded under the Exchange Act. The Court also observed that:

> "Almost any transaction with which a customer might not be satisfied, whether it violates the state law or not, might be characterized as violating such principle (assuming plaintiff's argument is correct). Furthermore, because the jurisdiction of the Federal Courts are exclusive under Section 27, the State Courts would be ousted of juris-

> diction of actions heretofore grounded upon state law alone if the contention of the plaintiff was accepted. This Court will not infer that Congress intended such drastic results without having explicitly so provided."

The Court, in Colonial Realty Corporation v. Bache & Co., cited with approval the case of Howard v. First National Bank, 238 F 2d, 790 at page 793.

If the contentions of appellants Penjaska are correct, it would mean that the Securities Exchange Act of 1934 ousted the State Courts of jurisdiction of actions heretofore grounded upon state law. That this was not the intention of Congress when it enacted the Securities Exchange Act of 1934 is clear from the ruling in the foregoing cases.

Appellants also argue that Rule 431 of the New York Stock Exchange Act regarding margin accounts is a rule which the Exchange had to enact because of the provisions of Section 19 (b) (12) of the Federal Securities and Exchange Act. The latter section simply provides, with respect to margin, that the Commission is authorized to request a Stock Exchange to effect its rules regarding many things and under Part 12 thereof, regarding minimum deposits on margin accounts. Section 19 (b) (12) does not purport to set specifications concerning the exact amount of

any such deposits or to determine by iron clad rule the preciseness or exactness of the method of handling of circumstances as they may arise in stock market dealings between a broker and customer. Significantly, the Securities Exchange Act requires that registered members of an exchange shall have rules. Yet the alleged violations of the rules of a Stock Exchange certainly do not oust the State Courts of jurisdiction. Under Section 27 of the Securities Exchange Act, the Board of Governors of the Federal Reserve System may from time to time with respect to all or specified securities or transactions, prescribe such margin requirements for initial extension or maintenance of credit as it may deem necessary or appropriate for the accommodation of commerce and industry, having due regard for the general credit condition of the country (15 U. S. Code Annotated, pages 246-247). Although the Sections of the Securities Exchange Act referred to make reference to the establishment of margin regulations, none of said sections attempt to set with exactitude the specifications of the margin requirements. This is left to the exchange as in the case of the New York Stock Exchange. The specifics governing margin, as may be required from time to time, are therefor set and determined by the rules of the New York Stock Exchange. In the case at bar, that rule is rule 431 requiring a minimum deposit of 25% on a when issued security. That rule was promulgated by

the New York Stock Exchange, and as in the case of Colonial Realty Corporation v. Bache & Co., supra, was enacted by the New York Stock Exchange pursuant to the direction contained in the Securities Exchange Act of 1934. It is noted that in Colonial Realty Corporation v. Bache & Co., the alleged violation of such rule of the New York Stock Exchange was held not to be a violation of the New York Stock Exchange Act which would thereby give jurisdiction to the Federal Courts. The direction of the Securities and Exchange Act of 1934 to the effect that exchanges shall promulgate regulations for themselves and their members so as to promote just and equitable principles of trade does not mean that violation of an alleged just and equitable principle of trade by a broker necessarily gives exclusive jurisdiction to a Federal Court. Yet, the Federal Securities and Exchange Act of 1934 directs that the stock exchanges adopt such rules. The Act does not purport to define or give the exact specifications as to what constitutes just and equitable principles of trade. However, this does not mean that an aggrieved party can merely allege violation of the Federal Securities and Exchange Act in that he was not dealt with on a just and equitable basis, and thereby place the litigation exclusively within the jurisdiction of the Federal Courts. By the same reasoning, although the Federal Securities and Exchange Act directs registered

exchanges to adopt rules and regulations concerning margin, an allegation by a party that his broker violated the rule of the New York Stock Exchange in that regard does not mean that the broker has also violated the Federal Securities and Exchange Act of 1934, nor does it by any means suggest that only Federal Courts may hear the aggrieved party's cause. As the Court stated in Rospigliosi v. Clougher, supra:

> ". . . But that does not mean that any rule or regulation which the exchange considered necessary becomes a rule under the statute, the violation of which would amount to a transgression of that law. It simply means that the exchange may have as many rules as it considers necessary to just operation. The provision of the Act as to any contract made in violation of any rule thereunder and the performance of any contract amounting to a violation of a rule thereunder refers distinctly to rules under this chapter (under the statute) and not to rules of an exchange which have been approved by the Securities and Exchange Commission."

The astuteness of the appellants Penjaska in attempting to bring their case within the complete purview of the Federal Securities Exchange Act of 1934,

and to contend therefrom that the Federal Courts had exclusive jurisdiction, is based entirely upon the fact that at the commencement of their account with their broker, there was sufficient margin, but the value of the when issued securities declined on the market after the account was open. When the broker called for margin on a declining market, the appellants Penjaska refused to cover the margin and the account did fall below margin. On that score, appellants Penjaska says that the Federal Securities and Exchange Act of 1934 was thereby and at that point violated, and therefore the Federal Courts had exclusive jurisdiction because appellants Penjaska filed an Answer and Counter Claim in the State Trial Court, thereby destroying the jurisdiction of the State Courts. In the alternative, appellants Penjaska plead and claim that the broker, appellee, was negligent and careless in that he failed to make a timely call for margin. If that were true, this could be an act of negligence or carelessness or breach of contract, the import of which is clearly triable in the State Courts. But it is the attempt of appellants Penjaska, through excrescence and superfluity, to connect their argument with the Federal Securities Exchange Act. If we follow that ascent far enough, countless claims of right can be discovered to have their source and operative limit in the provisions of a Federal statute or in the Constitution itself. To

set bounds to that pursuit, the Courts have formulated the distinction between controversies that are basic and those that are collateral, between disputes that are necessary and those that are merely possible (Howard v. Furst 238 F 2d 790). Every essential element of appellants' case depends upon the common law and the statutes of the State of Michigan. The fact that the claim of the appellants may be discovered to have its source or operative limit in the provisions of a Federal statute does not give the Federal Courts exclusive jurisdiction. Appellants raise a dispute which is "merely possible", but which dispute, as placed within the purview of the Federal statutes as appellants placed it, does not rely for the basic solution upon that statute.

CONCLUSION

For the reasons stated, appellants' appeal presents no substantial Federal question, and further, the judgment of the courts of the State of Michigan in this case rests on adequate non-Federal basis. The appellee motions this Court to dismiss appellants' appeal.

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Dated: August 12, 1968

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NO. 270

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

Paul Penjaska and John Penjaska, Appellants

V.

Goodbody & Company

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MICHIGAN

APPELLANTS' BRIEF IN OPPOSITION TO MOTION TO DISMISS

Paul Penjaska
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IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

NO. 270

Paul Penjaska and John Penjaska, Appellants

V.

Goodbody & Company

ON APPEAL FROM THE MICHIGAN SUPREME COURT

APPELLANTS' BRIEF IN OPPOSITION TO MOTION TO DISMISS

Appellee Goodbody & Co. bases its Motion To Dismiss appellants' Appeal on claim that the appeal does not present a substantial Federal question and that the judment of the Courts of the state of Michigan rests on adequate non-federal basis.

The questions presented by appellants in their Jurisdictional Statement concerned the validity of the contract between the parties under Section 29 (validity of Contracts) and other applicable provisions of the Act and whether jurisdiction of appellee's original suit was exclusive under Section 27 of the Act.

STATEMENT OF CASE

Inaccuracies and Omissions in Appellee's Statement -

The appellants Penjaska take exception to appellee's Statement of Facts as contained in appellee's Motion to Dismiss, There are several inacurracies and omissions by appellee regarding the pertinent facts of this case.

Appellee Goodbody & Co. omits showing the deterioration of appellants stock account and the over-extension of credit by appellee to appellants on the Studebaker-Packard when-issued securities during the period Feb. 3, 1960 to March 8, 1960. The status of the account and other pertinent facts are correctly set forth in appellants Jurisdictional Statement, pages 7 and 8 (Statement of Case). These facts are adequately supported by the Opinion of the trial court and by the Record. (Plaintiff's Declaration, R., Vol. I) (T.89-93).

On page 4 of appellee's Motion to Dismiss, appellee states:

> " The margin on said account remained sufficient until on or about Feb. 3, 1960 when the margin account call was made " -------

This is in error. Nothing in the Record shows that a margin call was made on Feb. 3, 1960. On the contrary, the Opinion of the trial court states:

> " Beginning with Feb. 3, 1960 the account needed margin but the account was not called. "

ARGUMENT

OVER-EXTENSION OF CREDIT BY APPELLEE TO APPELLANTS.

The status of the appellants account during the period Feb. 3, 1960 until March 8, 1960 shows that appellee Goodbody & Co. over-extended credit to appellants on securities registered on a national exchange beyond the time permitted by the minimum margin rules of the New York Stock Exchange, which are rules of an exchange required under section 19(b) and were made applicable to the Studebaker-Packard when-issued securities by the Securities Exchange Commission's rule 12F-1 of 17 CFR 240 promulgated pursuant to section 12(f) of the Act.

On March 8, 1960, when appellee first called for margin, the appellants entire deposit of $10,678.04 was already lost and there was a deficit in their account of $2,586.36. The

Opinion of the trial court states:

" Beginning with February 3, 1960 the account needed margin but the account was not called. The stock continued to decline in value and on March 8, 1960, the Plaintiff (appellee) Goodbody & Co. called on defendants (appellants Penjaska) for $8500. which defendants did not pay, but asked for further time. Plaintiff maintains that it sent out a sellout order on March 15, 1960, for sale on March 18th, but at the request of the defendants deferred sale until March 29th at which time the stock was sold, with a resulting loss to plaintiff in the sum of $4,050.79."

This shows that appellee Goodbody & Co. granted to appellants Penjaska an over-extension of credit during the periods Feb. 3, 1960 to March 8, 1960, from March 8, 1960 to March 18, 1960 and from March 18, 1960 until March 29, 1960 ---- all in violation of the minimum margin rules of the exchange, required under the Act.

In Staley v. Salveson (35 D & C 2d 318 Penn.) (1963) the court ruled that failure to liquidate an undermargined account promptly " consituted an unlawful extension and maintenance of credit and plaintiff (broker) cannot prevail. "

MINIMUM MARGIN RULES OF THE NEW YORK STOCK EX. REQUIRED UNDER SECTION 19(b) OF THE ACT

Appellee argues that Section 19(b) (12) does not set exact specifications regarding minimum margin deposits, that this is left to the exchange. Appellee further argues that the specifics governing margin in this case were set and determined by Rule 431

of the New York Stock Exchange not by section 19(b) of the Act and cites the case of Colonial Realty Corp. V. Bache & Co. (No. 63 Civ. 2240, Southern District of New York) in which, appellee says, the alleged violation of such a rule was held not to be a violation of the Act.

Appellee's position is untenable. In the Colonial case (No. 63 Civ. S. D. N. Y.) the alleged violation was not of the minimum margin rule itself, but of a written agreement between broker and his customer whereby the broker was not to sell securities in the customers margin account unless the equity owned fell below the minimum margin requirements of the exchange. There was no violation of the minimum margin rules of the Exchange by the broker in the Colonial case. In the case at bar the equity fell below the minimum margin requirements of the exchange. Thus, this ruling in the Colonial Case (No. 63 Civ. 2240 S. D. N. Y.) relied upon appellee Goodbody & Co. is inapplicable to the instant case.

Under section 19(b) the commission is authorized to impose changes in the rules of an exchange in regard to a variety of matters including minimum deposits on margin accounts (19b-12) if the rules are found by the commssion to be inadequate for public protection.

In Atlas Tack V. New York Stock Exchange (246 F. 2d 311) the court said:

> " Section 19(b) authorizes the commission after appropriate procedural steps, to impose upon exchanges, or rules of the exchanges, such rules as the commission deems necessary for public protection with reference to a variety of matters.

If the protection there accorded the public is inadequate due to faulty rules or procedures of exchanges, the remedy lies in a correction of these rules and procedures by the method set forth in section 19(b)."

Thus, the specifics in regard to minimum margin deposits are not solely set or determined by the rules of the exchange but can be changed or modified by the Commission if they are found to be inadequate for public protection. Therefore, the exchange's Minimum margin rules are rules of an exchange required under the Act.

The Colonial case cited by appellee (No. 63 Civ. 2240 S. D. N. Y.) was appealed, Colonial V. Bache & Co. (358 F. 2d 178) (1966). The court had this to say:

> " We cannot ignore that the concept of supervised self-regulation is broad enough to encompass a rule which provides what amounts to a substitute for regulation by the SEC itself. Not content with insisting upon Commission approval of exchange rules as a prerequisite to registration under section 6 and 15A, congress authorized the agency to request modification of particluar rules or to promulgate superceeding regulations on its own. A particular stock exchange rule could thus play an integral part in SEC regulation not withstanding the Commission's decision to take a back-seat role in its promulgation and enforcement and we would not wish to say that such a rule could not provide the basis of implying a private right of action. "

VALIDITY OF CONTRACTS

Appellee argues that a violation of the mimimum margin rule (Rule 431) of the New York Stock Exchange which sets the 25% minimum deposit and 25% minimum maintenance of that deposit on the when-issued securities, does not render a contract void, citing the case of Rospigliosi v. Clougher (46 South 2d 170) as upholding this contention. However, the exchange rule in the Rospigliosi case alleged to be violated was one which prohibits an employee of the broker from being interested in a customer's account.

" If there is any such regulation under the provisions of the Act with reference to an employee's interest in a customer's dealings no one has cited it." said the Florida Supreme Court. The court further held that for a contract to be void, the waiver must effect a provision of the Act, or rule or regulation thereunder, or rule of an exchange required thereby.

In contrast to the Rospigliosi suit, the basis of the contrversy in the case at bar involves the minimum margin rules of the exchange which are explicitly referred to under section 19(b) of the Act and rules and regulations thereunder and are therefore " rules of an exchange required thereby ".

The Opinion of the trial court states that proper demand was made on March 8, 1960 when appellee Goodbody Co. first called for margin although the account had been undermargined since February 3, 1960. Appellants feel it is pertinent to point out to the court that this was a determination of law, not of fact. Necessarily, this is a different finding as to what constitutes proper demand for margin if the contract is interpreted under non-Federal law then if interpreted under the

provisions of the Securities Exchange Act of 1934.

The question therefore is reduced to: did the contract between appellants Penjaska and appellee Goodbody & Co. contain " any stipulation or provision binding any person to waive compliance with ---- rule of an exchange required thereby"?

Paragraph 3 of Customer's Agreement (Defendants' Exhibit A item II, Vol. II of Record) (T. 62-63 and T. 83-84) states that customer (appellants) agreed to maintain the margin and that they would be liable for any deficit. (presumably even for a deficit arising out of a broker's violation of the Act.)

The trial court ruled (T. 94-96) (Opinion) that the contract stipulated that appellants agreed to maintain the margin; that appellee did not have to sell securities in the account if it remained undermargined since appellants agreed to protect their own account; and that appellants are liable for any deficiency even though appellee did not abide by the minimum margin rules of the New York Stock Exchange.

The contract, therefore, bound appellants to waive their protection under the Act and they were denied their rights. Section 29(a) makes contract void under the non-waiver provisions.

But appellee argues that appellants' pleadings in regard to the validity of the securities contract under section 29 (Validity of Contracts) constitutes merely a charge of simple breach of contract and that state statutes and common law were sufficient to provide a remedy; appellee further argues

that any reference to the Act by appellants in regard to validity of the contract was merely an "excrescence or superfluity " tacked on to an otherwise common law claim.

The astutness of appellee Goodbody & Co. through its attorneys in bringing its claim arising through over-extension of credit on a national exchange and bringing it under state law and contending therefrom that any defense claimed by appellants constituted a common law claim was based upon the contention that protection afforded the investing public under the Securities Exchange Act does not apply to customers in his dealings with his broker.

Section 29 of the Act is a Federal statutory provision regarding the validity of contracts involving securities. Appellants, as outlined in their Jurisdictional Statement, claimed in their pleadings throughout the Michigan Courts that the contract between the parties was void in regard to the rights of appellee Goodbody & Co. since appellee violated certain provisions - minimum margin maintenance regulations- of the Act. This is a Federal Claim. It was referred to and was a element in the decision of the highest court of the State of Mich. Normally, these are the only requisites for review by the U. S. Supreme Court of a civil case coming from a state court. (Hammond v. Whittredg 204 U.S. 538) (Anderson v. Brand 303 U.S. 95) , (Southern Bell V. Oklahoma 303 U.S. 206).

Appellee argues that appellants claim in regarding the validity of the contract do not present a substantial Federal question.

The appellants believe that if the decision of the Michigan Courts is allowed to stand

it will virtually nullify the protection to the investing public which the Securities Exchange Act of 1934 provides. In similiar circumstances the Supreme Court of Illinois ruled in Foreman v. Holsman (10 Ill. 2d 551) that the states blue sky law together with its voidability provision had been enacted " for the protection and benefit of the public as a whole " and concluded that permitting a waiver or " release " of this statutory voidability provision prior to or contemporaneously with the sale ---- would pave the way for virtual nullification of this important legislative enactment".

EXCLUSIVE FEDERAL JURISDICTION

Appelle Goodbody & Co. argues that it's pleadings and compaaint in the state courts consituted an action in debt and wasupon the common counts for debt over which the trial court of the state of Michigan had jurisdiction.

However, appellee's original suit is upon a contract involving registered securities traded upon a national exchange. Such a contract must comply to specifications as set forth in section 29 (Validity of Contracts) and other applicable sections of the Act. The contract has its gensis, therefore, in the Securities Exchange Act of 1934. Its enforcement has a distinct connection with the existence of a controversy arising under Federal Law. (Gully v. First National Bank in Meridian, 299 U.S. 109).

The subject matter contained in appellee's Declaration (Vol. I of Record) falls within an area pre-empted by the Federal Government. (Fifth Ave. Coach Lines, Inc. v. New York stock Exchange, 270 N. Y. S. 2d 352) (1966).

The opinion of the trial court that plaintiff (appellee Goodbody & Co.) had pleaded no federal claim was based upon the ruling in Colonial Realty v. Bache & Co. (U.S. D.C., S.D. N. Y.) Nov. 6; Civil 2240. However, this case is inapplicable to the case at bar since the alleged violation in the Colonial case was not of a rule of an exchange required by a provision of the Act or rules or regulations thereunder.

CONCLUSION

The questions pretaining to validity of contract and exclusive federal jurisdiction under the Securities Exchange Act of 1934, as outlined in appellants' Jurisdictional Statement, are substantial and properly before the court. If the order of the Mich. Supreme Court is allowed to stand it will pave the way for virtual nullification of this important legislation.

Probable jurisdiction should be noted.

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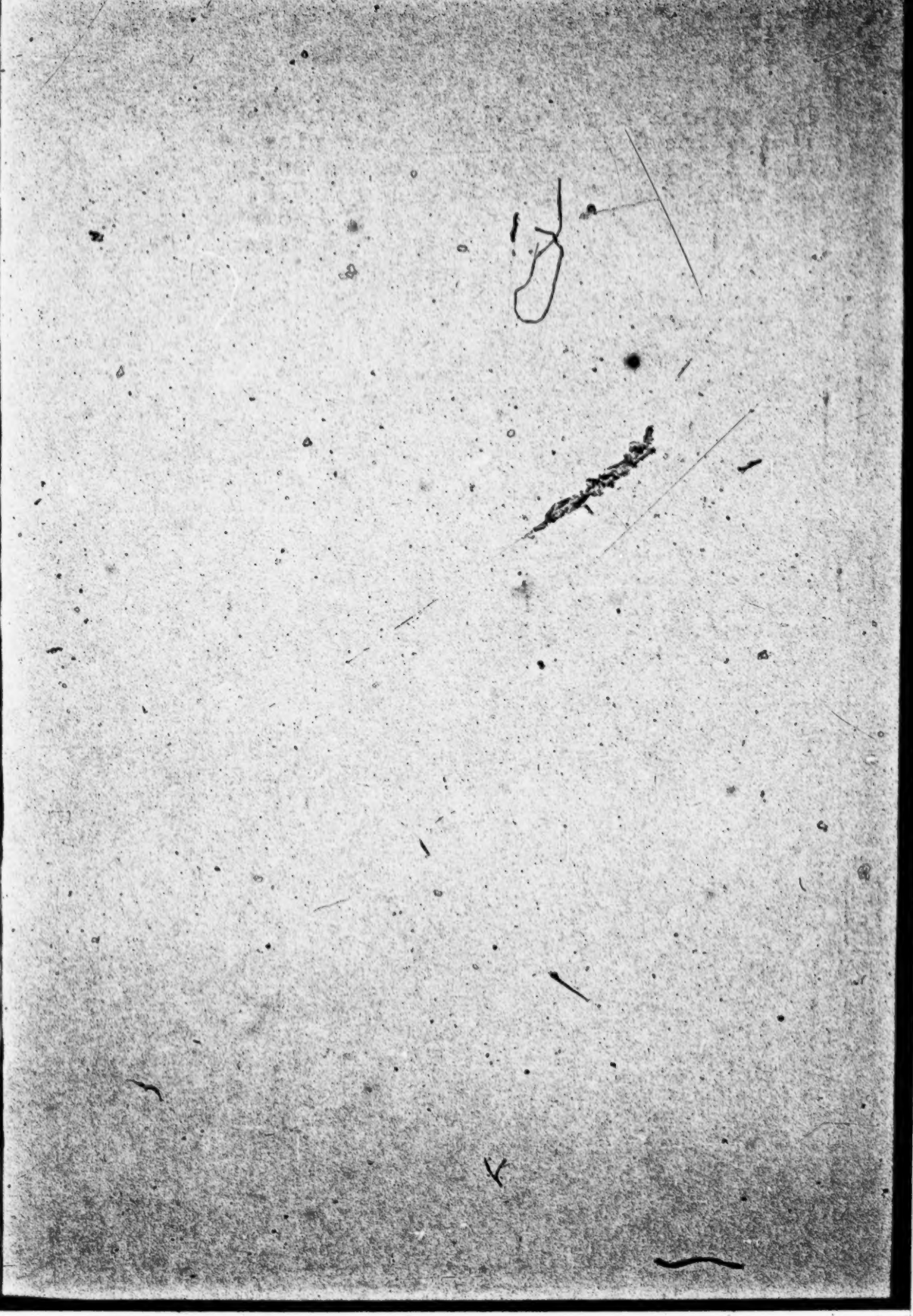

NO. 270

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

Paul Penjaska and John Penjaska, Petitioners

V.

Goodbody & Company

PETITION FOR REHEARING OF ORDER DENYING CERTIORARI

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28 U. S. Code 1257 (3)

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

No. 270

Paul Penjaska and John Penjaska, Petitioners

V.

Goodbody & Company

PETITION FOR REHEARING OF ORDER DENYING CERTIORARI

Petitioners respectfully request that this Court grant rehearing of its order dated October 14, 1968 which denied certiorari, and that the Court now grant certiorari.

Jurisdiction of the Court is invoked under 28 U.S. Code 1257 (3).

The petitioners present the following questions:

(1). Has the law pretaining to stock credit on margin, 76 ALR 1527, which the Michigan Courts enforced against petitioners, been made obsolete by Congressional enactment of 15 U.S.C.A. 78 ?
(See references for points in Headnotes, 8 Mich. App. 64).

(2). Can the Courts enforce a judgment based on a law which was made inoperative by superseding legislation enacted by Congress ?

The Michigan Court of Appeals, in affirming the trial court judgment against petitioners, based its decision on 76 ALR 1527 which was copyrighted in 1932 prior to enactment of 15 U.S.C.A. 78 and which concerns the " rights and duties of stockbroker and customer respectively where demand for additional margins is not complied with ". The Michigan Supreme Court upheld this decision.

76 ALR 1527 contains an annotation appended to a stock case, Spicer v. Hincks 113 Conn. 366 (June 22, 1931). It is divided into five parts of which part II (duty of a broker to close transaction) and part III (waiver of broker's right to close transaction) are pertinent to this case.

76 ALR 1527 is the authority relied upon by the Michigan Courts for points made in head notes 2, 4, 5, and 6, their essence being that a broker is not compelled to sell stock where a customer fails to comply with his request for more margin even though the account is undermargined in violation of the rules of the exchange and that broker may waive his right to sell the stock and give the customer more time in which to give additional margins. It was further held that a broker could recover any stock losses incurred by him thereby, upon sale of stock purchased by customer.

Paragraph II of 76 ALR 1527 states that broker has no legal duty to sell stock even when margin is exhausted. (Rubin v. Salomon, 241 N. Y. Supp. 495, 1930), and that no authority imposes an obligation upon broker to sell shares during a falling market after customer fails to furnish margin and that broker is not responsible for any loss to customer. (Kerr v. Murton 7 Ont. L. Rep. 751, 1904).

Petitioners maintain that the legal doctrine enunciated in paragraph II and III of 76 ALR 1527, concerning rights and duties of stockbroker and customer respectively where demand for additional margin is not complied with has been made inoperative in regard to the minimum margins which may be initally extended and subsequently maintained on any security registered on a national exchange, by enactment by Congress of 15 USCA 78 in 1934. It is noted that cases cited in 76 ALR 1527, paragraphs II and III were decided prior to the Act of 1934.

15 USCA Para. 78 is a federal statute enacted by Congress in 1934 to provide for regulation and control of credit that may be initially extended and subsequently maintained on any

security registered on a national securities exchange. (78g). It states that it shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts business through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer on any security registered on a national securities exchange, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve Board shall prescribe ------.

15 USCA 78g became effective October 1, 1934. (78hh-1). It is in contrast with the unrestricted credit extension and maintenance by a broker to his customer that prevailed prior to 1934 as described in para. III of 76 ALR 1527.

Paragraph III of 76 ALR 1527 states that, " even though a broker has a right to demand additional margin, and, on the customers refusal to give it, to sell the stock, yet he can waive it and give the customer more time in which to give additional margin. " Clark v. Meigs (1863). 10 BOSW. (N. Y.-) 337.

In contrast, 15 USCA paragraph 78cc contains a non-waiver provision whereby a broker may not waive compliance with 15 USCA 78g or with any provision of the title or rule or of any regulation thereunder or of any rule of an exchange required thereby. (78cc).

The Federal Reserve Board would be ousted of authority to restrict the use of credit for the purchase or carrying of securities (15 USCA 78g, 78w) if the broker had no legal duty to sell the stock when the customer failed to provide additional margin

as stated in paragraph II of 76 ALR 1527. The Securities Exchange Commission would likewise be stripped of power to enforce compliance with provisions of 15 USCA 78 by a member of a national securities exchange.

In U.S. v. McDermott 131 F 2d 313 Cert. Den. 765 it was held to be a criminal violation to extend and maintain credit by a member of the New York Stock Exchange to a customer in contravention of Federal Margin requirements of the Securities Exchange Act of 1934. (15 U.S.C.A. 78).

In the instant case Goodbody & Co. failed to liquidate petitioners undermargined account promptly and unlawfully extended and maintained credit. Goodbody & Co. are members of the New York Stock Exchange, a national securities exchange. The securities involved were registered and trading on the New York Stock Exchange.

The pertinent law applicable to the instant case is annotated in 1-100 ALR 2d " Securities Regulations " page 345 - 351, para. 16. These legal principals concerning the rights and duties of stockbrokers and customers respectively in regard to margin maintenance supersedes those outlined in paragraph II and III of 76 ALR 1527.

Paragraph 16, page 351 (1-100) ALR, " Securities Regulations " states:

" The federal securities laws require a high state of honesty and morality of brokers and dealers in transactions with customers; the law is violated by the broker and the customer may recover from him any loss proximately resulting therefrom where --- he extends credit to a customer in violation of the Act or regulations promulgated pursuant thereto. " Smith v. Bear. 60 ALR 2d 1119.

The Securities Exchange Commission promulgated regulations pursuant to the Act, applicable to the securities involved as outlined in petitioners appeal papers. These regulations effected the duty of Goodbody & Co. regarding minimum margins. The petitioners claim they were denied their rights under a statute (15 USCA 78) of the United States.

Jurisdiction to review this case by writ of certiorari is granted the U. S. Supreme Court by U. S. Code 1257 (3).

Summary

The petitioners claim that the Michigan courts enforced obsolete laws (76 ALR 1527) regarding stock margins which were made inopeerative by superseding legislation (15 USCA 78) enacted by congress and that the correct law to apply in this case is 15 USCA 78. The pertinent law is annotated in 1-100 ALR 2d para. 16.

Conclusion

For the reasons set forth in this petition for rehearing, as well as in the Jurisdictional Statement and Appellants' Brief in Opposition to Motion to Dismiss, previously filed, which appeal papers were treated as a petition for a writ of certiorari, rehearing should now be granted.

Respectfully submitted,

Paul Penjaska
Paul Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867

John Penjaska
John Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867

DATED: 4 Nov. 1968

CERTIFICATE OF GOOD FAITH

Pursuant to Rule 58, I hereby certify that the foregoing Petition for Rehearing is Presented in good faith and not for delay, and is restricted to the grounds specified in paragraph 2 of Rule 58.

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DATED: 4 Nov. 1968

SUPREME COURT OF THE UNITED STATES

October Term, 1968.

PENJASKA *v.* GOODBODY & CO.

APPEAL FROM THE SUPREME COURT OF MICHIGAN.

No. 270. Decided October 14, 1968.

PER CURIAM.

The motion to dismiss is granted and the appeal is dismissed for want of jurisdiction. Treating the papers whereon the appeal was taken as a petition for a writ of certiorari, certiorari is denied.